

**CITY OF LINCOLN**  
**POLICE & FIRE PENSION ADVISORY COMMITTEE MEETING**  
**3:00 P.M., THURSDAY, AUGUST 1, 2002**  
**CONFERENCE ROOM 106**

Members present: Aaron Drake, Jim George, Mark Westphalen, Joe Yindrick, Mark Meyerson, Michael Donnelly,

Members absent: None

Personnel Dept.  
Resource Staff: Georgia Glass, John Cripe, Paul Lutomski

Others present: Terrance Sherrill, Ron Flansburg, Greg Sorensen, Todd Dondlinger, Ed Sheridan

Aaron Drake welcomes all present to the meeting and asks visitors to introduce themselves. Asks Paul Lutomski to present recent activities.

Paul Lutomski: Item A. Vote to approve or amend summary minutes of May 2, 2002 meeting (Audio tapes provided to Fire and Police Unions).

Mark Westphalen: Move to approve.

Jim George: Second the motion.

Aaron Drake: All in favor?

All: Aye.

Paul Lutomski: Item B. Mayor Wesely's June 24, 2002 budget press release states pension to receive \$250,000 increase to a total of \$1.6 million for FY 2002-03. Two funding requests were made. The first was for a flat \$2.8 million. This was calculated by multiplying 8/31/01 valuation payroll by the minimum recommend contribution amount. This method was also presented as "Scenario #2" in the Mayor's Special Task Force May 4, 2001 memo to Mayor Wesely. The second was an ordinance change mandating a 5% City contribution in FY 2002-03 followed by a 1% annual increase thereafter until full City normal cost is reached. On hold due to current budget shortfall situation. Below is a cost estimate given to Georgia to give to Mayor Wesely.

Fiscal Year	Valuation Payroll After DROP	City Contribution Percent	City Contribution Amount
2002-03	\$26,000,000	5%	\$1,300,000
2003-04	\$27,040,000	6%	\$1,622,400
2004-05	\$28,121,600	7%	\$1,968,512
2005-06	\$29,246,464	8%	\$2,339,717
2006-07	\$30,416,323	9%	\$2,737,469
2007-08	\$31,632,975	10%	\$3,163,298
2008-09	\$32,898,294	11%	\$3,618,812
2009-10	\$34,214,226	12%	\$4,105,707

Item C. DROP enrollment is now at 47 members (up from 40 on May 1st) and \$112,000 payment each month.

Item D. Pages 4 – 7: Balance Sheet, equity and debt asset returns as of June 30, 2002.

Item E. June 30, 2002 Fiscal Year to Date return was 2.56%. If that rate holds for the entire FY we estimate the pension to be roughly 100% funded +/- \$2M.

Jim George: Underfunding will be a new situation. What impact will underfunding have on our funding requests?

Mark Meyerson: The ordinance states the City shall contribute, not may contribute.

Jim George: City is not to the top of the lid per Nebraska law so we should increase tax up to lid max to fund the pension when it becomes underfunded.

Georgia Glass: We will talk to Finance Director Don Herz regarding funding. Mr. Herz is a proponent of adequate funding and of a real COLA.

John Cripe: We asked for a Charter Amendment to guarantee funding. The Mayor suggested an ordinance instead. Now the ordinance is on hold.

Georgia Glass: We have been talking with the Mayor and City Council members regarding funding. Jon Camp wanted to have a pre-council session on pension funding. We will do that.

Mark Westphalen: The information I receive forecasts a very soft, slow economic recovery. The City may be in a worse financial situation next year than it is in this year. I make a motion that this committee write a letter to mayor Wesely, the City Council, and Don Herz expressing our concerns regarding current and future pension funding in light of weak economic conditions and advocate a pro-active response to funding.

Jim George: Second.

Aaron Drake: All in favor?

All: Aye.

Paul Lutomski:

Item F. In the May 2, 2002 meeting it was reported that the ordinance to target a minimum \$675 monthly payment was put on hold. The reasons given were that Mayor Wesely preferred to use the money toward a true COLA if possible, and that the City Attorney's office said the increased payment would be illegal. Since then clarification was obtained from the City Attorney. They stated it would be illegal because the increase must be based on real and verifiable increases in the cost of living. Toward that end we have obtained CPI data from 1913 forward. We are ready to apply this CPI data to calculate a new increase, but have not done so because of the discussions regarding a true COLA.

Item G. Debt restructuring. Sold 10 yr TSTRIP with proceeds of \$4 and 5 pieces of 10 yr CMOs with proceeds totaling \$16M, and reinvested all proceeds into 2-3 year CMOs. Increased monthly coupon income by \$6,000.

Item H. Equity restructuring to attain better risk/reward profile. Transfer \$4.8M from Vanguard International Index to American Fund EuroPacific Growth Fund. Transfer \$2.6M American Funds SmallCap World Fund to Vanguard's SmallCap Index Fund. Transfer \$2.6M Vanguard Total Stock Market Index, \$0.6M American Funds Growth Fund of America, \$1M American Funds New Economy Fund and \$4M American Funds Investment Company of America, to American Fund Washington Mutual.

Item I. Pages 8 -9, and 10+: Alternative Investments amendment to the Investment Policy.

Please read the prepared summary of alternative investments: (reprinted below)

**We would like to introduce a 10% “Alternative Investments” allocation to the Police and Fire Pension Investment Policy.**

The first hedge fund was set up by Alfred W. Jones in 1949 to “hedge his bets” on the stocks he managed. Today a hedge fund is considered a type of Alternative Investment. Alternative Investment refers to any private investment limited partnerships using sophisticated techniques to trade and offset risk whether they use strategies to hedge their bets or not.

There are about \$600 billion invested in alternative investments worldwide. They are similar to mutual funds in that they pool investor money and invest it collectively.

Alternative investments can differ significantly from mutual funds because:

- They may hold very few securities, thereby increasing risk and potential return.
- They are not required to register under federal securities laws.
- They are only available to accredited investors (individuals with a net worth of at least \$1,500,000 or entities with assets over \$5,000,000).
- Only 99 limited partners (investors) are allowed to invest.
- Minimum investment amount is high.
- There are restrictions regarding entry and exit from the partnership.

Hedge Funds add these differences:

- A significant portion of the manager’s net worth is invested in the fund.
- They have an absolute-return investment objective.
- Compensate managers based on performance.
- Favorable risk/return vs. equity and debt.
- Low correlation to equity and debt that increases diversification and reduces total portfolio volatility.
- Ability to profit in rising and falling markets.

Some Public funds using alternative investments to increase diversification and reduce risk are:

- \$150 billion CalPERS
- \$22 billion Illinois Teachers’ Retirement System
- \$11 billion San Francisco (CA) City and County Employee’s Retirement System
- \$10 billion Indiana Public Employees’ Retirement Fund
- \$6 billion Louisiana State Employees’ Retirement System
- \$3 billion Contra Costa County California Employees’ Retirement System
- \$259 million New Haven Connecticut Police and Fireman’s Pension Fund
- \$143 million Arapahoe County Colorado Pension Fund

Advisors are available to consult with investors regarding the purchase and monitoring of alternative investments. Fund Managers offering alternative investments range from large established institutions to small newly opened shops. As an unregistered investment they are not overseen by the SEC and are prohibited from advertising. Many investment strategies are available and restrictions exist regarding entry and exit. For example, there are limits to the number of investors and total dollar amount that can be invested as well as limits on the amount and timing of withdrawals. An increasingly popular method to invest in hedge funds is to use a Fund-of-hedge-funds Manager. Based on current and forecasted economic conditions, the fund-of-funds manager decides on how to allocate the pooled investment among several investment strategies, and then selects managers within the strategies. The fund-of-funds manager performs due diligence, monitors performance, replaces managers, and reports to the investor. These

managers may be able to attract better hedge fund managers, negotiate better fees and less entry/exit restrictions because they have a larger investment base than an individual investor.

PF Pension administration's desired approach to alternative investing would be to use two types of funds. First, a concentrated long equity fund. Second, a multi-strategy fund-of-hedge-funds manager from a large established company with a proven track record. Hedge Fund criteria should include 10+ managers and at least five different styles, a hurdle rate, a loss carry forward provision and audited accounting records. Higher level of liquidity is preferable.

Mark Westphalen and Michael Donnelly discuss risk versus return with pension administration. Mr. Donnelly endorses administration's recommendation to use an established hedge-fund-of-funds manager as the safest way to participate in the risky investment class and makes a motion to amend the investment policy to allow a maximum 5% asset allocation to alternative investments. Jim George seconds the motion. It is agreed that before any investment is made the committee will be provided more specific data, including exact returns.

Paul Lutomski: Pension Analysis system fixed and implemented July 16, 2002. Computer consultant cost will be finalized when I get the last timesheet ending July 31, 2002. Estimate is \$49,950. We have written a memo to Finance Director Don Herz seeking reimbursement for all/part of the cost.

Georgia Glass: I spoke to Don Herz. We need to talk more before a final decision. If it is determined that the Finance Department will reimburse the pension for part of the costs, it would then need to be determined how the reimbursement is done.

John Cripe: I advocate that computer services are provided to the pension free of charge for the time it takes to recover the reimbursement amount. I could see 50% reimbursed.

Aaron Drake: Let's deviate from the agenda to offer a discussion of new topics before discussing item K, as that item may take a while to review.

Ron Flansburg (retired Police Captain) asks that the Advisory Committee be changed to include representation of retired members. Police and Fire Union committee members state that the timing for that is not good as they working to replace the Advisory Committee with a pension Board of Trustees. General discussion ensues that Mr. Flansburg is welcome to come to the meetings, that they occur at 3 p.m. the first Thursday of August, November, February and May, and that announcements are in the newspaper.

Greg Sorensen (current Police Sergeant) asks that Plan B and C DROP entry window be changed so that plan B or C members be allowed to enter DROP anytime, like Plan A members. He is willing to re-start contributions after age 53 for this ability. General discussion that this option was discussed and costed during the two years of DROP development negotiations and that the timing is not good for amending the DROP as it is a new addition to the pension and because the unions are working on a new 85% benefit structure.

Mark Meyerson inquires regarding the status of creating a pension Board of Trustees. Georgia Glass states an ordinance has been created, but she does not know what the plans are to proceed with it, and that the Mayor's office has the ordinance. Union members of the committee agree that that working document created by the Mayor's department did not grant the Board of Trustees enough power and that they would like to see the ordinance. Georgia refers them to Mayor Wesely.

At 5:00 p.m. Paul Lutomski and John Cripe leave the meeting. It is decided to hold another meeting August 22, 2002 to discuss the actuarial cost estimate of the 85% pension benefit structure.

Meeting is adjourned.